

**REGULAR STATE BANKING BOARD MEETING  
HELD BY CONFERENCE CALL  
OFFICE OF THE COMMISSIONER  
DEPARTMENT OF FINANCIAL INSTITUTIONS  
2000 SCHAFER STREET, SUITE G  
BISMARCK, NORTH DAKOTA**

**November 13, 2003**

The regular meeting of the State Banking Board was held in the Office of the Commissioner, Department of Financial Institutions, 2000 Schafer Street, Suite G, Bismarck, North Dakota. Chairman Karsky called the meeting to order at 9:05 a.m., Thursday, November 13, 2003, by conference call.

MEMBERS PRESENT: Timothy J. Karsky, Chairman (*Office*)  
Ron Braseth, Member (*Mayville*)  
Bill Daniel, Member (*Office*)  
Launa Moldenhauer, Member (*Office*)  
Gary Petersen, Member (*New Town*)  
Terry Zeltinger, Member (*Minot*)

MEMBER ABSENT: Roger Monson, Member

ALSO PRESENT: Robert J. Entringer, Assistant Commissioner (*Office*)  
Jeff Jungman, Chief Examiner – Banks (*Office*)  
Scott Miller, Assistant Attorney General (*Office*)  
Darrell Moon (*McVile*)  
Sue Miller (*Minneapolis*)  
Rick Miller (*Minneapolis*)  
Tom Capouch (*Portland*)  
Stan Koppinger (*Rugby*)  
Greg Vetter (*Office*)

**APPROVAL OF MINUTES**

Chairman Karsky indicated the Board received copies of the minutes of the regular meeting held on September 13, 2003, and the special meetings held on September 30, 2003, and October 30, 2003. **It was moved by Member**

**Moldenhauer, seconded by Member Braseth, and unanimously carried, with Member Monson absent, to approve the minutes as published.**

## **MCVILLE STATE BANK, MCVILLE – APPLICATION TO ESTABLISH A FACILITY IN SYKESTON**

Chairman Karsky referred to his September 3, 2003, Memorandum which indicates the application was published as required by North Dakota Administrative Code. The bank's trade area is a 10 mile radius of Sykeston and no banks are located within that trade area; therefore, no banks received direct notice. There were no comments or requests for copies of the application.

Chairman Karsky reviewed the statutory criteria found in Section 6-03-13.3 of the North Dakota Century Code. Regarding the first criterion, Chairman Karsky noted that Security State Bank of North Dakota, Hannaford, previously had a facility located in Sykeston and closed that facility on April 30, 1997. McVile State Bank is purchasing the former building of Security State Bank of North Dakota, Hannaford, for \$3,000, and estimates fit-up costs of approximately \$10,000. The application notes the City of Sykeston has a population of 153 people and the nearest banking facility is located 14 miles away. The application indicates the population is predominantly elderly and for many of those it is difficult to drive out of town to conduct their banking business. No formal survey was done to assess the needs of the community; however, in visiting with people informally, it was evident they strongly feel the need to have a bank in their community. Reportedly, a representative of the community had asked the McVile State Bank to open a facility in Sykeston, and because there is no facility currently located in Sykeston at this time the Department feels the area is in need of financial services and would benefit the community.

The second criterion deals with the financial strength of the bank in relation to the cost of establishing and maintaining the facility. With the total cost of establishing the facility at approximately \$15,000, it does not appear to put a burden on the overall financial condition of the McVile State Bank. The projections indicate the facility is expected to lose approximately \$10,000 during the first year of operation, and \$12,550 in the second year of operation. The bank projects to show an estimated profit of approximately \$38,500 at the end of the third year of operation. It does not appear that any bank would be seriously injured by approval of the application.

Chairman Karsky asked Darrell Moon, President, to review the reasons for applying to establish a facility in Sykeston. President Moon indicated it has been a new process for the bank to establish facilities, and the facility the bank established in Binford in 2001 has been a totally positive experience. The bank has been very successful with this facility, in fact they need more help in that facility. He stated with the application to establish a facility in Sykeston, they do have an individual who is living in Carrington that will be able to handle loans at both the Binford and Sykeston facilities.

Chairman Karsky asked President Moon if the Binford location has been profitable, and President Moon indicated it has based on the volume of loans they have obtained in that location.

Member Moldenhauer inquired as to the proposed hours of operation, and President Moon indicated the hours would likely be 8:30 a.m. to 3:00 p.m., five days per week.

President Moon indicated the bank hopes to open the facility by December 1, 2003, but no later than the end of the year. President Moon indicated the proposed manager of the Sykeston facility has been employed by the bank since the middle of August and will live in Carrington so he can work at both Binford and Sykeston.

**It was moved by Member Petersen and seconded by Member Daniel to approve the application of McVile State Bank, McVile, to establish a facility at 16 Main Street, Sykeston, and to approve the proposed Order authorizing Chairman Karsky to sign on behalf of the Board. The motion carried by a vote of 6 to 0, with Member Monson absent.**

## **MERCHANTS BANK, RUGBY – TO CLOSE TOWNER FACILITY**

Assistant Commissioner Entringer reviewed the letter received from Merchants Bank, Rugby, requesting permission to close its facility located at 305 Main Street, Towner, along with the necessary requirements.

Assistant Commissioner Entringer noted that he spoke with Stan Koppinger, President, early in September 2003 as to the requirements to close its facility in Towner. He stated the requirements are to publish notice of the intention to close and direct comments to the State Banking Board. Assistant Commissioner

Entringer indicated the Department did not receive any comments regarding the notice, and President Koppinger indicated the bank did not receive any comments either.

Information included with the letter was the legal notice which was published in *The Mouse River Journal* on Wednesday, September 24, 2003, which ran for two consecutive weeks. The bank also posted a notice in the bank's Towner location lobby on September 22, 2003, and also sent a letter to all Towner customers indicating their intention to close the facility.

Assistant Commissioner Entringer asked President Koppinger to review for the Board the reasons for closing the facility.

President Koppinger indicated he has been with the bank for approximately one year, and shortly after starting he began reviewing the operation in Towner, but wanted to take enough time to make a good decision as to whether to close the facility or not. President Koppinger indicated Towner is located approximately 18 miles from Rugby and the facility has been open for 6 years. During that time the facility has had fairly low volume and has, in fact, lost \$300,000 over that 6 year timeframe. President Koppinger indicated most of the loan volume was generated from Rugby and added that the bank has tried to do promotions such as a debit card in Towner, but only two individuals took the bank's offer. President Koppinger indicated the bank is not leaving the community of Towner without a facility, as Western State Bank, Devils Lake, does have a facility located in Towner also. President Koppinger stated the Board of Directors voted to close the facility on September 16, 2003, based on the information from the due diligence assessment. President Koppinger indicated the employee operating the Towner facility will not be terminated, as she has accepted a position in Rugby.

**It was moved by Member Moldenhauer, seconded by Member Braseth, and unanimously carried by a vote of 6 to 0, with Member Monson absent, to grant approval for the Merchants Bank, Rugby, to close its facility located at 305 Main Street, Towner.**

## **TRUST CENTER OF AMERICA, BISMARCK – AMENDMENT TO THE ARTICLES OF INCORPORATION**

Assistant Commissioner Entringer reviewed the Articles of Amendment, indicating that Trust Center of America, Bismarck, is requesting approval to

change its name to American Trust Center, and to change its principal executive office to 140 1<sup>st</sup> Avenue West, Dickinson. Assistant Commissioner Entringer explained at the present time the main office is located at 320 North Fourth Street, Bismarck, which is the office of Bank Center First; however, it is the intention of the owners of the trust company to transfer the fiduciary assets from American State Bank and Trust of Dickinson to the trust company, and that is the reason they are requesting to change the principal office.

Assistant Commissioner Entringer noted that the statute requires that a subsidiary trust company such as Trust Center of America is only allowed to have offices at the main office of the parent company, and in this case it would be the main office of American State Bank and Trust of Dickinson and Bank Center First, Bismarck.

Assistant Commissioner Entringer asked Greg Vetter if he had any additional comments for the Board. Mr. Vetter indicated the reason for the change of principal office is: (1) the original Articles of Incorporation still state the principal office is 212 North 4<sup>th</sup> Street, Bismarck, which is the address of Investment Centers of America, where Trust Center of America used to be located. When the trust company was acquired by Bank Center First and American State Bank and Trust of Dickinson the Articles were never amended to change the location of the trust company; and (2) the plan for Trust Center of America is to merge the assets from trust department of American State Bank and Trust of Dickinson into Trust Center of America, and they are looking at doing that in the next few months. Mr. Vetter indicated both Boards of Directors have approved the transfer of the fiduciary assets into Trust Center of America, and it is the goal that going forward, all trust operations will be handled out of Dickinson. Mr. Vetter continued that he is currently working on the budget for next year and with the combined fiduciary assets, and they are hopeful that within the next 12 to 24 months Trust Center of America will be profitable.

**It was moved by Member Zeltinger and seconded by Member Petersen to approve the Articles of Amendment to the Articles of Incorporation for Trust Center of America to change its name to American Trust Center, and to change its principal executive office to 140 1<sup>st</sup> Avenue West, Dickinson. The motion was carried by a vote of 6 to 0, with Member Monson absent.**

**AMERICAN STATE BANK AND TRUST OF DICKINSON, DICKINSON,  
AND BANK CENTER FIRST, BISMARCK, TO INCREASE INVESTMENT  
IN THE TRUST COMPANY SUBSIDIARY**

Assistant Commissioner Entringer indicated American State Bank and Trust of Dickinson and Bank Center First presently have authorization to invest \$350,000 each in the subsidiary, and are requesting approval to invest an additional \$150,000 each, so that each bank would be authorized to invest \$500,000 in the subsidiary trust company. Attached to the letter request are a balance sheet as of September 30, 2003, and a pro forma balance sheet as of December 31, 2003, before the additional capital injection and a pro forma balance after the \$300,000 capital injection, as well as a summary of the projected cash flow for the combined entity for 2004.

Assistant Commissioner Entringer asked Mr. Vetter to review the information for the State Banking Board. Mr. Vetter indicated the trust company is operating at a loss and the trust company currently has \$45 million in assets under management. Mr. Vetter indicated the projected operating loss through year-end is \$108,000, and projecting that out through year-end would indicate they would have accounts payable of approximately \$50,000. Mr. Vetter indicated the \$300,000 capital injection would enable the trust company to cover its operating loss and begin the new year with approximately \$243,000 in cash on hand. Mr. Vetter indicated with the combined assets from American State Bank and Trust of Dickinson, the trust company is projecting a small profit for 2004 and added that it is the feeling that this injection would carry the trust company through as the trust company grows and becomes profitable.

Chairman Karsky noted that if a trust department of a bank is unprofitable, it is subsidized by the commercial operations of the bank. However, in this case, since Trust Center of America is a separate stand-alone company, when the operating losses affect capital the parent companies need to inject capital.

Assistant Commissioner Entringer noted that the reason the request is before the Board is Section 6-03-38, North Dakota Century Code, requires the State Banking Board to approve investments in subsidiary companies.

**It was moved by Member Moldenhauer, seconded by Member Daniel, and carried by a vote of 6 to 0, with Member Monson absent, to approve the request by American State Bank and Trust of Dickinson and Bank Center First, Bismarck, to each invest an additional \$150,000 in Trust Center of America.**

## **NORTHLAND FINANCIAL, STEELE – ARTICLES OF AMENDMENT TO THE ARTICLES OF INCORPORATION**

Assistant Commissioner Entringer stated Northland Financial, Steele, is requesting to change its number of directors from not less than 3 or more than 10, to 9.

**It was moved by Member Braseth, seconded by Member Petersen, and unanimously carried by a vote of 6 to 0, with Member Monson absent, to approve the Articles of Amendment to the Articles of Incorporation for Northland Financial, Steele, to change its number of directors from not less than 3 or more than 10, to 9.**

## **ITEMS TO BE NOTED**

### *Comptroller of the Currency*

Received 10-6-03, U.S. Bank National Association North Dakota, Fargo, application to merge filing under Section 1206 of the American Homeownership and Economic Opportunity Act of 2000.

Effective 9-1-03, Bremer Bank, NA, Grand Forks, to close branch located at 1 Main Street, Forest River, North Dakota.

## **DISCUSSION ITEMS**

### *Bank-Owned Life Insurance Informally Funding Rank and File Employee Benefits*

Assistant Commissioner Entringer referred to the letter received from Sue Miller with Clark Consulting. Assistant Commissioner Entringer indicated he had received a telephone call in early September 2003 from Sue Miller and Rick Miller, Clark Consulting, to discuss the Department's position with regard to a bank's ability to purchase bank-owned life insurance which would be used to offset or recover employee benefit costs for all bank employees, as well as benefits provided to executive-level employees under non-qualified plans. The type of benefits that the insurance would cover for rank and file employees would include

qualified plans such as a 401(k) match, a defined benefit pension plan, medical, profit sharing, and post-retirement medical. The plan would also cover non-qualified plans such as deferred compensation and SERP.

Assistant Commissioner Entringer indicated in reviewing the request, the Department looked at the limitations found in the North Dakota Administrative Code and could not find anything that specifically prohibited the request as set forth by Clark Consulting. In reviewing the letter, Chairman Karsky indicated he felt the Board should review the request and consider the comments from Clark Consulting.

Assistant Commissioner Entringer asked Sue Miller and Rick Miller to discuss the request for the Board. Sue Miller indicated the North Dakota law includes a provision which allows banks to purchase life insurance in connection with compensation and benefit plans for its officers, directors, and employees, and Clark Consulting is looking for confirmation that a bank can purchase BOLI to fund things such as a 401(k) or medical expenses for employees. Ms. Miller indicated that routinely across the country BOLI is purchased for this purpose, as well as to fund non-qualified benefit plans. Rick Miller indicated the OCC Bulletin talks about this and it is quite clear that the OCC approves of banks using BOLI for the purpose of offsetting or recovering the costs of rank and file employee benefits. Mr. Miller indicated that typically you will see BOLI being purchased to finance the cost of a non-qualified plan and all Clark Consulting is asking for is that the Department recognize that BOLI can also be used to fund rank and file benefits. Mr. Miller added this is a win-win situation since the bank is able to find a way to finance the employee benefit costs and by doing so, can provide additional benefits to rank and file employees. A scenario would likely be where a bank purchases life insurance on its executive officers, and it should be clear that the life insurance is on executive officers who are highly paid and highly compensated within the bank organization, and the life insurance is considered an asset of the bank. The life insurance policy earns tax free interest, although the income is accumulated to the value of the policy, it is not actually paid to the bank. However, what it does do is free up other income which can be used to provide for things like an employer match on a 401(k) plan, or to pay the employer's part of a premium on health or dental insurance.

Assistant Commissioner Entringer indicated that Chairman Karsky had inquired as to whether we could get a letter from the OCC stating they do allow this type of situation. Assistant Commissioner Entringer stated it was his understanding the OCC was reluctant to issue such a specific letter because it is



already addressed in the Bulletin. Assistant Commissioner Entringer asked Mr. Miller if that was correct; Mr. Miller indicated it was correct and added that the OCC considers the Bulletin to be their “last word” on the matter. Mr. Miller stated in that Bulletin the OCC indicates national banks, as many other corporations, do use corporate-owned life insurance as a financing or cost recovery tool or vehicle for pre and post retirement benefits. When Clark Consulting asked the OCC what their interpretation of that was, the OCC said it speaks for itself, but it does apply to rank and file employees as well as benefit plans that would cover executive officers.

Chairman Karsky added that the limitations on individual policies in the North Dakota Administrative Code would still apply. Mr. Miller indicated that was correct; however, the issue is rather than use BOLI to fund for instance a SERP plan for the CEO of a bank, you might use it to fund a health insurance plan for all of your rank and file employees or all employees of the bank. Mr. Miller stated you may still want to use some of it to fund a SERP benefit for the executive, but you would have the option.

Assistant Commissioner Entringer asked Mr. Miller how the bank determines how much of the income from the policy would be used to fund the SERP and how much for the rank and file benefit plan, or is there a need to do such an analysis. Mr. Miller indicated that Clark Consulting does not do any analysis, but that the bank would know what its own benefit liabilities are and would have to make some sort of business decision as to how to allocate the costs. Mr. Miller continued that you cannot really get cash out of the policy unless you are willing to give up the tax-free inside buildup; therefore, what the bank is doing is drawing upon its own cash reserves to fund that benefit until the bank can recover the cost. When that happens it is upon the death of one of the executives whom is insured; therefore, the cost recovery comes later and until that time you use your own cash reserves to cover that benefit. Ms. Miller added that before a bank purchases BOLI it must go through a pre-purchase analysis and one of the steps included is to estimate its actual benefit costs; therefore, a bank would be required to say how much they spend on 401(k) or employee benefits, or similar items.

Member Petersen indicated these types of assets are looked at closely by the regulator and since he is not an owner of one of these types of policies, he is not acutely aware of what they regulators look at, and asked if there were additional negative elements as to what is proposed to be done beyond what is normally looked at in an examination regarding the purchase of BOLI. Mr. Miller responded there is no additional risk, stating this is a typical BOLI arrangement

that is simply outside of what the Department has seen up to this point. Mr. Miller indicated he is not sure a lot of North Dakota banks have actually done this, but it does not change the dynamics since you still go through the pre-purchase analysis and the regulators would still view this as a BOLI purchase under the same criteria as any other BOLI purchase.

Chairman Karsky asked if a policy is purchased to fund rank and file benefits as suggested and the policy is purchased on a highly compensated executive that leaves the bank, is the policy then transferred to another executive. Mr. Miller indicated under North Dakota law you are permitted to purchase a policy on someone you have an insurable interest and that you are allowed to keep that policy until their death. Mr. Miller stated, in other words if the bank wants to purchase a policy on an executive, it first has to determine that they have an insurable interest and once that is established, they are allowed under the insurance code to keep that policy until the death of that executive. In the instance described, if that individual does not stay at the bank until death, the bank is still relying on the income derived from that policy and would recover the costs upon the individual's death. Mr. Miller indicated the short answer is that the bank is allowed to keep the policy after the executive left the bank.

Chief Examiner – Banks Jungman referred to the North Dakota Administrative Code which prohibits a bank from owning key-man life insurance after that individual is no longer employed at the bank. Mr. Miller indicated that is an excellent point; however, it is important to note that there is a distinction between key-man life insurance which is purchased to insure the bank in the event of a loss of that key person either by death or that individual leaving the bank. BOLI is distinctly different from key-person life insurance as it covers executives not only while they are employed at the bank, but afterwards. Mr. Miller indicated when you buy key-man life insurance it has a limited purpose, but when you buy BOLI the bank, carrier, and executive all understand the purpose is different in that the bank is not going to realize a return on its outlays until the executive dies. Therefore, if you buy insurance and do not allow the bank to keep it, you are out all the money paid out in the intervening years to fund these different benefit plans for the executives and employees.

Chairman Karsky added this is something the Department has not encountered before and that is why the individuals from Clark Consulting are here to discuss this with the Board, and to get input from the Board as to their perspective as bankers.

Assistant Commissioner Entringer summarized what Clark Consulting is asking for is some type of confirmation from the Department that this type of BOLI arrangement to fund rank and file employee benefits is permissible under the North Dakota Administrative Code. He reiterated that the letter was reviewed by Assistant Attorney General Scott Miller, whom agreed it would be allowed based on the limitations contained in the North Dakota Administrative Code.

Mr. Miller indicated when they handle a purchase of BOLI for a bank they are very careful to make sure the limitations of the law are followed and, in fact, most banks cannot buy enough BOLI to cover their benefit costs.

Chief Examiner – Banks Jungman asked Mr. Miller if an executive who is insured by a BOLI policy is terminated by the bank for participating in a defalcation how that would affect the policy. Ms. Miller indicated most agreements include a provision where an employee who has been terminated for cause loses their benefits, but that the bank would still be permitted to retain the policy on the individual. Mr. Miller indicated that the bank typically would not insure just one executive unless it is a very small bank; therefore, they would look at the executive management group for purposes of purchasing BOLI.

Member Daniel left the meeting at 9:52 a.m.

Chairman Karsky asked Member Petersen if he was comfortable with what has been discussed and would agree this is something the Board could conclude is authorized. Member Petersen indicated he did not want to cause undue concern; however, he did want to make sure if the State Banking Board says this is authorized and during an examination a bank would have to defend its purchase of BOLI for purposes of covering rank and file employee benefits. Assistant Commissioner Entringer indicated this was certainly something we would have to educate our staff on to ensure they are aware that this is something the limitations would allow under the North Dakota Administrative Code.

Chairman Karsky indicated he felt the Board has reached the consensus that this would be authorized under the limitations.

## **THE FIRST AND FARMERS BANK, PORTLAND – LIFE INSURANCE WAIVER REQUEST**

Chairman Karsky referred to the letter submitted by President Capouch dated September 5, 2003, requesting a waiver of the limitations for owning life insurance after an individual is no longer employed by the bank.

Assistant Commissioner Entringer indicated he and President Capouch talked in late August subsequent to an examination of the bank because the Department had cited a violation of holding life insurance policies on former directors of The First and Farmers Bank. Assistant Commissioner Entringer explained what happened is when the bank was purchased by the current ownership group there were deferred compensation plans by the bank for the former directors and a number of those individuals opted to take a lump sum payout of their deferred compensation when the acquisition was completed. As a result, the policies are still owned by the bank but these individuals are no longer directors or shareholders of the bank. The Department cited an apparent violation; however, as indicated in President Capouch's letter, the purpose of the BOLI was to cover the benefit plan and that full cost recovery does not occur until the death of those directors. President Capouch indicated of the six directors, four of those did take a lump sum payment, but two are still receiving periodic payments for their deferred compensation.

Assistant Commissioner Entringer indicated Sue Miller, Rick Miller, and Tom Capouch had separate conversations with him and all indicated even though a bank may have paid out its liability under a deferred compensation plan, the bank has not recovered its costs until the insured individual dies, which is when the cost recovery occurs. Based on this interpretation, the question becomes, is there a continuing liability under the North Dakota Administrative Code or can the rule be interpreted in such a manner as these individuals have indicated, that there is a continuing liability because the costs of the bank have not been fully recovered.

President Capouch indicated it is the bank's position that even though these individuals are no longer on the bank's Board of Directors, the bank has not fully recovered its cost and will not until the death of these individuals. President Capouch indicated the four were paid out at their request based on their tax positions, and he was unaware this would cause other issues.

Chairman Karsky indicated he is in favor of granting a waiver on this request since if the bank had not paid out the lump sum there would be a continuing liability, as there is on the two directors who opted not to receive a lump sum payout.

Assistant Commissioner Entringer asked Sue or Rick Miller to comment on why cost recovery does not occur under a situation such as this until the death of the insured. Mr. Miller indicated he would like to read a sentence from the OCC Bulletin that addresses this. “A corporation purchases a certain amount of life insurance on the lives of certain employees so that the gain from insurance proceeds reimburses the corporation for the benefit payment.” Mr. Miller indicated they do not really talk about the bank’s liability, what they do talk about is reimbursement for the costs of the bank providing this benefit to the employee while they are alive or to others while the insured person is alive. Therefore, while North Dakota has in the North Dakota Administrative Code a sentence about this liability, it does not fully capture the full purpose of the BOLI or how the BOLI works in real life. The purpose is to reimburse the corporation for the outlays they have made during that employee’s life. Ms. Miller indicated it does not matter if it is a lump sum payment or a payment over 10-15 years, the fact is that the bank has laid out its funds and has not recovered that money until the death of the insured individual.

Chairman Karsky stated this should have been addressed as an “Approval Item” rather than a “Discussion Item”, because he would like the Board to act on the waiver request of The First and Farmers Bank, Portland.

**It was moved by Member Braseth, seconded by Member Moldenhauer, and carried by a vote of 5 to 0, with Members Daniel and Monson absent, to approve the waiver request by The First and Farmers Bank, Portland, to continue to own the life insurance policies on the former directors.**

The Board went into closed session at 10:02 a.m.

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Timothy J. Karsky, Chairman

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Robert J. Entringer, Secretary